

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 ISO-00 AID-05 CIAE-00 COME-00 EB-08
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R 231438Z MAR 77
FM AMEMBASSY LONDON
TO TREASURY DEPT WASHDC
SECSTATE WASHDC 1861
INFO AMEMBASSY BONN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
AMCONSUL EDINBURGH
USMISSION OECD PARIS
USMISSION EC BRUSSELS

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E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: BANK OF ENGLAND QUARTERLY

SUMMARY: IN ITS FIRST QUARTERLY BULLETIN OF 1977 THE
BANK OF ENGLAND REVIEWS THE VERY UNSETTLED ECONOMIC CLI-
MATE OF 1976 AND SUGGESTS THAT 1977 COULD BE A CALMER
BUT STILL DIFFICULT YEAR. THE BANK BELIEVES THAT
MUCH DEPENDS ON THE EXTENT TO WHICH THE IMPROVED STATE OF
FINANCIAL CONFIDENCE CAN BE CONSOLIDATED. THE LOWER-THAN-
ANTICIPATED CURRENT LEVEL OF GOVERNMENT BORROWING MAY PER-
MIT A LIMITED EASING OF FISCAL POLICY IN THE UPCOMING
BUDGET. HOWEVER, THE BANK WARNS THAT IT WOULD BE IMPRO-
DENT TO CONSIDER SUCH A CHANGE UNLESS THERE WAS A GOOD
PROSPECT OF A MATERIAL REDUCTION IN THE RATE OF INFLATION.
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LOOKING FURTHER AHEAD, THE BANK BELIEVES THAT WHILE NORTH
SEA OIL WILL EASE THE EXTERNAL CONSTRAINTS THAT HAVE AF-
FECTED THE ECONOMY IN RECENT YEARS' A PERSISTENT CURRENT
ACCOUNT SURPLUS WILL BE NECESSARY TO REPAY EXISTING FOR-
EIGN DEBT. AT THE SAME TIME, BRITAIN MUST REMAIN COMPE-
TITIVE IN NON-OIL TRADE OR RISK DISSIPATING THE BENE-
FITS OF NORTH SEA OIL. THE FOLLOWING MESSAGE SUMMARIZES

THE HIGHLIGHTS OF THE QUARTERLY BULLETIN. END SUMMARY.

1. OUTPUT DEMAND AND EMPLOYMENT.

GROSS DOMESTIC PRODUCT ROSE ABOUT 2.2 PERCENT BETWEEN THE FOURTH QUARTERS OF 1975 AND 1976 WITH THE MAIN IMPETUS COMING FROM A LIMITED RECOVERY IN MANUFACTURING PRODUCTION AND HIGHER EXPORT VOLUME. THE BANK EXPECTS A SLOW EXPANSION OF GDP IN 1977 WITH THE LARGEST CONTRIBUTION COMING FROM THE TRADE BALANCE. CURRENT EXPENDITURE BY CONSUMERS AND GOVERNMENT ARE LIKELY TO BE DEPRESSED WHILE DECLINING PUBLIC INVESTMENT AND HOUSING CONSTRUCTION WILL OFFSET A RECOVERY IN PRIVATE MANUFACTURING INVESTMENT LATER IN THE YEAR. DESPITE THE SLOWER RISE IN UNEMPLOYMENT OF RECENT MONTHS, THE BANK HOLDS OUT LITTLE PROSPECT FOR A SIGNIFICANT DECLINE IN 1977. CURRENT ANNUAL RISES IN THE LABOR FORCE OF 0.5 PERCENT COUPLED WITH TREND INCREASES IN PRODUCTIVITY OF 2.5 TO 3.0 PERCENT IMPLY THAT UNEMPLOYMENT WILL ONLY BEGIN TO DROP WHEN A GROWTH RATE OF 3 TO 3.5 PERCENT BECOMES SUSTAINABLE.

2. COSTS AND PRICES.

THE BANK NOTES THE IMPACT OF STERLING'S 1976 DECLINE ON RETAIL AND WHOLESALE PRICES BUT GIVES NO INDICATION OF WHAT INCREASE IT ANTICIPATES FOR 1977. IT ALSO OBSERVES THAT AVERAGE EARNINGS ROSE AT AN ANNUAL RATE OF 13.5 PERCENT DURING THE FIRST 5 MONTHS OF THE SECOND YEAR OF WAGE RESTRAINT. THIS IS CONSIDERABLY FASTER THAN THE 7 TO 8 PERCENT FIGURE WHICH WOULD BE CONSISTENT WITH THE TERMS OF THE PRESENT INCOMES POLICY. ACCORDING TO THE BANK, THE UNCLASSIFIED

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DISCREPANCY MAY BE THE RESULT OF INCREASED OVERTIME IN ADVANCE OF THE LONG CHRISTMAS-NEW YEAR HOLIDAY PERIOD AS WELL AS LATE SETTLEMENTS AND BACK PAYMENTS UNDER THE TERMS OF THE FIRST YEAR OF INCOMES POLICY.

3. PERSONAL INCOME.

REAL DISPOSABLE PERSONAL INCOME DECLINED BY ABOUT 1.3 PERCENT IN 1976, BUT REAL CONSUMER EXPENDITURE ROSE BY 0.6 PERCENT AS THE SAVING RATIO DECLINED FROM A HISTORIC HIGH OF 14.1 PERCENT IN 1975 TO ABOUT 12.4 PERCENT IN 1976. THE BANK NOTES THAT BETWEEN THE FOURTH QUARTERS OF 1974 AND 1976, THE SAVINGS RATIO HAS DECLINED ABOUT 5 PERCENTAGE POINTS (15.5 TO 10.5). THIS DROP IS ATTRIBUTED TO DECLINING REAL INCOMES AND MODERATING INFLATION.

4. COMPANY SPENDING AND FINANCE.

DESPITE A 26.5 PERCENT RISE IN GROSS CORPORATE PROFITS BETWEEN THE THIRD QUARTERS OF 1975 AND 1976, NET COMPANY PROFITS AFTER ALLOWANCE FOR INVENTORY APPRECIATION AND DE-

PRECIATION BUT BEFORE TAXES, ROSE ONLY BY 6.5 PERCENT.
THE SHARE OF NET PROFITS IN NET NATIONAL INCOME DECLINED
FROM 4.4 TO 4.2 PERCENT DURING THIS PERIOD. THAT SHARE
STOOD AT 10.4 PERCENT DURING THE LAST CYCLICAL PEAK YEAR
OF 1972. THE THIRD QUARTER PROFITS DECLINE IS EXPLAINED

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R 231438Z MAR 77
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BY THE BANK IN TERMS OF STAGNATING INDUSTRIAL OUTPUT AND
A DECLINE IN EXPORTS. THERE IS SOME INDICATION THAT THE
INCREASING FLOW OF NORTH SEA OIL WILL BUOY THE FOURTH QUAR
TER PROFIT FIGURES. FIXED INVESTMENT IN THE PRIVATE SEC-
TOR DECLINED BY 4 PERCENT IN 1976 WITH A HESITANT UPTURN
BEGINNING IN THE SECOND QUARTER. THERE ARE INDICATIONS
OF A 95 MILLION POUND (1970 PRICES) INCREASE IN PRIVATE
SECTOR INVENTORIES. IF BORNE OUT, THIS WOULD PLACE THE
NET CHANGE IN INVENTORIES OVER 1976 AT ABOUT ZERO. THE
BANK ATTRIBUTES SOME OF THE FOURTH QUARTER BUILD-UP TO A
DESIRE TO TAKE ADVANTAGE OF CERTAIN CORPORATION TAX RE-

LIEFS BY FIRMS WHOSE FINANCIAL YEAR ENDED DECEMBER 31.

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5. PUBLIC SECTOR.

LOWER DEBT INTEREST PAYMENTS AND IMPROVED CONTROL OVER PUBLIC EXPENDITURE COUPLED WITH HIGHER-THAN-ANTICIPATED REVENUES BROUGHT ABOUT A TIGHTER FISCAL POLICY STANCE IN FY 76. HOWEVER' THE BANK WARNS THAT THE NEED TO REDUCE PUBLIC SECTOR BORROWING MEANS THAT EXPENDITURE CUTS MUST BE LARGER THAN TAX REDUCTIONS ALTHOUGH A SHIFT IN THE BURDEN OF TAXATION FROM DIRECT TO INDIRECT TAXES WOULD BE PERMISSIBLE. COMMENTING ON THE SHAPE OF THE PLANNED SPENDING CUTS FOR FY 77 AND FY 78, THE BANK OBSERVES THAT "THE SQUEEZE ON SPENDING . . . WILL BE REFLECTED MAINLY IN SMALLER SUBSIDIES AND IN LOWER LENDING TO THE PRIVATE AND OVERSEAS SECTORS, BOTH OF WHICH WILL PROBABLY HAVE A RELATIVELY SMALL EFFECT ON DEMAND." IT ADDS THAT 60 PERCENT OF THE CUTS WILL FALL ON LOCAL GOVERNMENT SPENDING.

6. MONETARY DEVELOPMENTS.

AFTER DESCRIBING EVENTS LEADING TO THE MASSIVE SALES OF GILTS BETWEEN OCTOBER AND JANUARY WHICH CONTRIBUTED TO A REVERSAL OF THE RAPID RATES OF INCREASE IN THE MONETARY AGGREGATES, THE BANK POINTS TO A 420 MILLION POUND DECLINE IN STERLING LENDING TO PRIVATE AND OVERSEAS SECTORS DURING THE OCTOBER-JANUARY QUARTER. IT ATTRIBUTES THIS BOTH TO HIGHER INTEREST RATES AND THE REINTRODUCTION OF THE CORSET LIMITING THE RATE OF INCREASE IN BANKS' INTEREST-BEARING ELIGIBLE LIABILITIES (IBELS). THE BANK OBSERVES THAT IN RECENT MONTHS THE IBELS' GROWTH RATE HAS DROPPED TO A RANGE WHERE FEW BANKS WILL INCUR ANY PENALTY PAYMENTS UNDER THE CORSET RULE. THIS CONTRACTION IN BANK LENDING WAS ACHIEVED WITHOUT "UNDULY RESTRAINING LENDING TO THE PRIVATE SECTOR." THE BANK NOTES THAT TOTAL STERLING LENDING TO THE PRIVATE SECTOR IN THE JANUARY QUARTER ROSE BY 1.02 BILLION POUNDS COMPARED WITH AN AVERAGE OF 1.12 BILLION IN THE PREVIOUS TWO QUARTERS. THIS RESULT WAS MADE POSSIBLE BY PUBLIC SECTOR REPAYMENT

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OF BANK CREDIT IN THE WAKE OF SALES OF GILTS AND OVERSEAS REPAYMENTS OF STERLING CREDIT (200 MILLION POUNDS IN THE OCTOBER-JANUARY QUARTER) AS EXCHANGE CONTROLS WERE IMPOSED ON THE FINANCE OF THIRD COUNTRY TRADE. THUS, THE

IMF CONDITIONS RELATIVE TO DOMESTIC CREDIT EXPANSION AND M3 FOR THE CURRENT FISCAL YEAR (9.0 BILLION POUNDS AND 9 TO 13 PERCENT, RESPECTIVELY) ARE CERTAIN TO BE ACHIEVED, ACCORDING TO THE BANK.

7. BALANCE OF PAYMENTS.

THE BANK LOOKS FOR A NARROWING OF THE CURRENT ACCOUNT DEFICIT IN 1977 STEMMING BOTH FROM NORTH SEA OIL PRODUCTION AND AN EXPANSION IN WORLD TRADE. THE BANK POINTS TO THE COMPETITIVE RATE OF STERLING AND THE EXISTENCE OF

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SPARE CAPACITY IN MOST SECTORS AS FAVORABLE ELEMENTS FOR U.K. EXPORTS.

8. EUROCURRENCY MARKETS.

THE BANK STATES THAT THE EUROCURRENCY MARKET GREW MUCH FASTER IN THE FOURTH QUARTER OF 1976 THAN IN THE

PREVIOUS TWO WITH TOTAL FOREIGN CURRENCY LIABILITIES INCREASING TO 202.6 BILLION DOLLARS FROM 188.0 BILLION IN THE THIRD QUARTER. THIS WAS MATCHED BY A CORRESPONDING RISE IN ASSETS FROM 189.3 TO 203.9 BILLION DOLLARS DURING THE SAME PERIOD. HOWEVER, THERE WAS A NOTICEABLE SHORTENING OF THE MATURITY OF THE BANKS' LIABILITIES WITH NET BORROWING AT LESS THAN 8 DAYS RISING FROM 25 PERCENT TO UNCLASSIFIED

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29 PERCENT OF TOTAL NET BORROWING UP TO A YEAR. THIS CHANGE IN THE MATURITY STRUCTURE IS ATTRIBUTED TO EXPECTATIONS OF DECLINING EURO CURRENCY RATES WITH OPERATIONS BY U.S. AND JAPANESE BANKS RESPONSIBLE FOR MOST OF THE SHIFT.

9. OIL MONEY MOVEMENTS.

TOTAL OIL REVENUES OF THE EXPORTING COUNTRIES ROSE 16.5 BILLION DOLLARS TO ABOUT 113 BILLION IN 1976. HOWEVER, THE CASH SURPLUS AVAILABLE FOR OVERSEAS INVESTMENT AND OTHER PURPOSES DECLINED BY 1.25 BILLION DOLLARS IN THE FOURTH QUARTER BRINGING THE TOTAL 1976 SURPLUS TO 33 BILLION DOLLARS COMPARED WITH 35.5 BILLION IN 1975. THE BANK ESTIMATES THAT OF THE 7.3 BILLION DOLLAR FOURTH QUARTER SURPLUS. 1.7 BILLION WAS PLACED IN THE U.S., 1.6 BILLION IN FOREIGN CURRENCY DEPOSITS IN THE U.K., 3.8 BILLION IN BANK DEPOSITS AND SPECIAL BILATERAL FACILITIES IN OTHER COUNTRIES, AND 0.1 BILLION WITH INTERNATIONAL ORGANIZATIONS.

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